This single chapter on economic trends and outlook is excerpted from the FY 2005 Country Commercial Guide for Kuwait. The full text of the report is also available on this website.

CHAPTER 2
ECONOMIC TRENDS AND OUTLOOK

MAJOR TRENDS AND OUTLOOK

Oil Sector:
Oil production and related industries drive the Kuwaiti economy. Kuwait's crude oil production in 2003 averaged just over two million barrels per day (b/d); total production capacity is estimated at 2.4 million b/d. The country's refining capacity is currently around 800,000 b/d. OPEC production agreements as of November 2001 limit Kuwait crude oil production to 1.74 million b/d, but Kuwait plans to expand production capacity to three million b/d by 2005. Future plans also call for expanding domestic refining capacity to one million b/d, while increasing Kuwait's ability to produce higher valued refined products.

Non – Oil Sector:
Kuwait's non-oil economy grew by 6.4 percent in 2003. Driving the growth in non-oil GDP was a surge in manufacturing activities that grew by 20.6 in 2003. Construction and private consumption grew at an equal rate of 5.4 percent. An increased government spending of 10 percent and an increase of 9.9 percent in gross capital formation also contributed to the growth. (Source: Ministry of Planning).

The Kuwaiti Government is trying to reduce the percentage of expatriate labor in Kuwait. Kuwait is working to replace higher-paid expatriate workers in the government and private sectors with Kuwaitis who are more likely to spend their earnings domestically. Besides "Kuwaitization" policies, the increasingly expensive residences fees, new requirements for expatriate's health coverage, raising living costs, and stagnant salaries have driven many expatriates to leave Kuwait permanently.

PRINICIPAL GROWTH SECTORS
Non-Oil Sector:
Without fundamental economic restructuring, long-term growth in the non-oil sector will be tied to the whims and fluctuations of international oil markets. Broad reforms are needed to reduce the role of the government in the economy, to reduce the dependence of the government on oil revenues, and to induce more Kuwaitis to seek employment in the private sector. Such measures might include steps to create a more favorable investment climate (for both foreign and domestic investors), to reduce government subsidies, and to expand and accelerate nascent efforts at privatization. Key areas where the government's role should be reexamined include:

- *Telecommunications*: In June 2001, Kuwait divested itself of US $540.2 million--over half of its holdings--in the Mobile Telecommunication Company (MTC). Further change could bring in Western companies as partners, along with badly needed investments in infrastructure and new technologies.

- *Housing*: Demand for housing in Kuwait is rising because of generous housing subsidies and the country's high population growth rates. Kuwait's Minister of Planning stated that the government intends to support the 3.3 percent annual increase in population. Anathema to Kuwait's budgetary pressures and scarcity of building sites may promote the construction of multi-unit developments rather than individual homes.

- *Power Generation*: Subsidies distort the market by giving little incentive for consumers to use power rationally, leading to massive leaps in demand growth. A restructured sector would provide appropriate price signals both to consumers (to reign in demand) and to producers (to build new power plants).

- *Health Care*: Kuwait is moving to privatize some of its health care services by establishing private hospitals. In the future, government-owned hospitals may be privately managed as well. Furthermore, recent legislation requires all expatriates workers to have health insurance. This should create opportunities for health insurance and/or health maintenance organizations and provide funding for additional projects such as Afiya Net, a program to automate patient record keeping.

- *Food Sector*: Snack foods, vegetable oils, frozen beef, frozen chicken parts, cheeses, frozen and fresh vegetables, sauces and condiments.

Oil Sector:
Kuwait's government-owned oil sector is expected to maintain its long-term expansion, subject to constraints imposed by OPEC quotas. After many years of debate, the Kuwait government has decided to allow foreign participation in the upstream oil sector. It is in the process of drafting regulations that would allow the operation of international oil companies in Kuwait's Northern oil fields. The project is expected to generate billions of dollars of new investment in the country and create thousands of jobs, as well as granting Kuwait access to the latest techniques and technologies in oil recovery.

The petrochemical sector offers particularly exciting opportunities for growth. The US $2 billion EQUATE petrochemical complex in the Shuaiba Industrial Area was created as a joint venture between Union Carbide Corporation (45 percent), the government-owned Petrochemicals Industries Company (45 percent) and Boubiyan (10 percent), a group of private Kuwait investors. (Union Carbide has subsequently merged into Dow Chemical.) The availability of intermediate petrochemical products such as ethylene, polyethylene, and ethylene glycol is expected to open opportunities for a range of chemical and plastic manufacturing industries in Kuwait.

GOVERNMENT'S ROLE IN THE ECONOMY

Kuwait's government has historically played a dominant role in the local economy. The over-regulated system restricts competition in certain sectors of the economy and strictly controls access by foreign capital and expatriate labor. Efforts to transform the system from a welfare state into a market economy will progress slowly as the Kuwaiti people cling to their government-provided entitlements.

In early 2001, Kuwait's National Assembly passed a new Foreign Investment Law that grants 10-year tax holidays and other incentives to new foreign investors. Among other things, the law provides for up to 100 percent foreign ownership in certain sectors. However the implementing rules and regulations were published on February 23, 2003. The Cabinet had also issued a resolution on November 9, 2003, defining the areas where foreign ownership will be allowed. The National Assembly passed legislation that would reduce maximum corporate tax rates for foreign firms from 55 percent to 25 percent. However, it is still in the process of drafting implementation procedures.

As part of its ‘privatization’ drive, the Kuwait government has successfully divested its equity holdings in a number of Kuwait firms, including private companies and most of the nation’s banks. Kuwait has implemented its divestiture program using public auctions through the Kuwait Stock Exchange, negotiated sales to strategic investors, or a combination of the two. The government had purchased many of these shares following the collapse of the Souk Al-Manakh and to provide capital for local development.

The government’s efforts to guarantee employment for all Kuwaiti nationals, comes at the cost of inefficiency and higher youth unemployment. Ninety-three percent of the Kuwait workforce is employed by the government or government-owned companies. While there has been a social benefit, “Kuwaitization” has resulted in overstaffed government ministries. Private companies also have difficulty recruiting and retaining Kuwaitis for demanding jobs at competitive wages. To ameliorate this problem, the National Assembly passed the National Employment Law in April 2000, which extends government-provided social and child allowances to citizens employed in the private sector; only government employees had received these benefits before. The government hopes this new law will make private sector employment more attractive to Kuwaitis, particularly new graduates. The bill also establishes unemployment assistance for Kuwaitis waiting to find a job in either the government or private sector. These payments are limited to a few months to encourage recipients to find employment. These steps, of course, add significantly to the government’s social spending obligations.

KUWAIT GOVERNMENT BUDGET ALLOCATIONS
(Billion US $)

1 U.S. $ = KD .299	**2004/2005**
Income	11.10
Oil (1)	9.13
Non-Oil (2)	1.97
Expenditures	20.69
Salaries	5.82
Goods & Services	3.10
Transport Equipment	0.20
Construction	2.49
Misc. Expenditures & Transfer Payments	9.08
Fund for Future Generation	1.11

(1) Oil revenue is based on US $15 per barrel for FY ¾ and 04/05. Kuwaiti crude averaged about US $27/bbl in 2003.

(2) Non-oil revenue is derived from corporate tax revenue (imposed only on foreign companies), customs duties, and various government fees.

Each year, the government deposits 10 percent of government income into the Fund for Future Generation.

BALANCE OF PAYMENTS

Kuwait had a 2003 balance of trade surplus of US $8.5 billion and a current account surplus of US $4.7 billion (estimated). Given current world oil prices, both surpluses are expected to remain healthy through 2004.

INFRASTRUCTURE

Kuwait's size protects it from the distribution challenges faced by larger countries. It has two modern ports--Shuwaikh and Shuaiba--which handle most of the country's imported goods. Both are equipped with facilities to manage most kinds of cargo. Shuwaikh is the regular port of entry for most consumer goods entering by container ship. Shuaiba, located in Kuwait's refining and manufacturing complex, receives some of the country's industrial imports and is the export point for petrochemicals, sulfur, and petroleum coke.

Kuwait is working to regain its role as a transshipment point in the region following the significant drop in world trade with Iraq after the Gulf War. In 1996, the government authorized the establishment of a free trade zone in Shuwaikh port, which was inaugurated in November 1996. Over 90 percent of available space has been leased. The Kuwaiti government has also reduced some port fees to encourage use of Kuwait as a transshipment point.

TRANSPORTATION

Kuwait's road system is well developed, with modern multi-lane expressways linking all areas of the country. There are no railways in the country. Kuwait International Airport is located south of the city and is easily accessible by expressway. It offers regular flights to destinations in the Middle East, Europe, and Asia and can provide service for the world's largest aircraft.

UTILITIES

Kuwait has several major electric power generating plants which, by incorporating desalination operations, are also the source of the country's potable water supply. Kuwait strives to maintain a 90-day supply of water at all times. Power plants can be fired by either natural gas or fuel oil. Kuwait's surging population and subsidized prices, however, have created rapidly rising demand for electricity and water. Demand is particularly high during the summer months--when temperatures routinely reach above 130 degrees Fahrenheit--because of the need for extensive air conditioning.

INTERNET & E-COMMERCE

Kuwait currently has four licensed Internet Service Providers (ISP) and more than 50 sub-ISPs. Estimates of total Internet users in Kuwait range from 180,000 and up. Internet access prices remain high as the Ministry of Communications retains control of both local telephone service and marine cable and satellite telecommunications in and out of Kuwait.

A growing number of Kuwaiti businesses are expressing interest in electronic commerce and mobile commerce (via cellular telephone and the wireless application protocol or WAP) for business-to-business and business-to-consumer applications. Several local banks offer Internet banking services and even online brokerage services for the U.S. stock market.

The government has placed considerable emphasis on moving toward "e-government", but the legal and technical infrastructure for this is developing slowly. For example, an electronic signature law, based largely on the United Nations Commission on International Trade Law (UNCITRAL)'s model law on Electronic Commerce, continues to await legislative action.

REGIONAL ECONOMIC INTEGRATION

Kuwait is a member of the Gulf Cooperation Council (GCC). At its December 2001 meeting, the GCC council announced that a GCC customs union would come into effect in January 2003 with tariff rates at 5.5 percent for exempted and basic commodities and 7.5 percent for other commodities. In April 2003, the National Assembly adopted the unified tariff rate will be 5 percent. GCC states are now working assiduously to harmonize tariff schedules and clearance procedures.

OUTREACH INTO IRAQ – SPECIAL INITIATIVE

Given security conditions and the lack of an established CS Baghdad team, CS Kuwait has developed business opportunities for American and Kuwaiti companies in Iraq, especially in Basrah. By identifying trade shows, launching seminars and missions, partnering with other CS posts, AmEmbassy Baghdad, CPA and local business organizations such as the American Business Council, as well as extensive networking within Iraq, CS Kuwait has already assisted hundreds of companies in learning more about the business environment and in establishing relations with the GOI and with the Iraqi private sector. Key industry sectors include oil and petroleum, agriculture, healthcare, port development, iron and steel, fertilizer, concrete and cement, and security.

In cooperation with CS Baghdad, CS Kuwait will continue to link American and Kuwaiti business representatives with Iraqi to the best of our ability. Post will implement the following concrete actions in the short-term:

1. promote the Basrah Business Centre as a resource to Americans and Kuwaitis;
2. develop a special Platinum Key for Iraq for U.S. clients, to enable them to enter and expand operations throughout the country;
3. propose to the incoming permanent CS Baghdad management team a joint event in Kuwait for the Iraqi Ministry of Defense to present its needs to American defense contractors during October 2004;
4. support American-led consortia in making investments in Basrah in heavy industry, in particular to navigate various federal agencies in Washington, D.C.;
5. has already offered to the head of the new Iraq Reconstruction Management Office (IRMO) to host a fall 2004 conference in Kuwait to promote its opportunities and procedures to the business community throughout the region;
6. continue to help vetted Iraqi citizens to obtain Kuwaiti visas to meet American firms in a safer environment for the Gold Key program;
7. will lead business missions into the south whenever security conditions permit;
8. will recruit a delegation of local companies to attend the trade show, Rebuild Iraq, in April 2005;
9. will invite Iraqi from the south to participate on IBP delegations to the USA, until such time as CS Baghdad is able to manage such recruitment internally;
10. continue to use our own post webpage to promote reconstruction in Iraq.

In sum, CS Kuwait has the unique ability to help American and Kuwaiti companies increase their Iraqi business, from Kuwait as well as inside Iraq. As soon as CS Baghdad is established and able to manage its programs especially in the south, CS Kuwait will withdraw turning over all contacts and actions, cooperating on an ad hoc basis.

Please Note:

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